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ACTION TRSE-00

INFO OCT-01 EUR-12 EA-07 NEA-10 ISO-00 CIAE-00 PM-04

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USADB

FOR NAC AGENCIES

E O 11652: ADS, DECLAS 7/1/77

TAGS: EAID, EFIN, CE

SUBJ: PROPOSED ADB TECHNICAL ASSISTANCE TO SRI LANKA FOR
SEVANAGALA SUGAR DEVELOPMENT PROJECT

REF: MANILA 4481

SUMMARY: ADB MANAGEMENT PROPOSES \$350,000 TECHNICAL
ASSISTANCE (TA) GRANT TO GOVT OF SRI LANKA FOR THE FORMULA-
TION OF AN INTEGRATED SUGAR DEVELOPMENT PROJECT TO BE
FINANCED UNDER THE FINANCING ARRANGEMENTS CONCLUDED WITH
THE EUROPEAN ECONOMIC COMMUNITY (EEC) IN JANUARY 1977.
USADB RECOMMENDS FAVORABLE NAC ACTION. END SUMMARY.

1. ADB DOC. R33-77 DESCRIBING PROPOSED TA GRANT POUCHED
ADDRESSEES ON MARCH 28. BOARD CONSIDERATION SCHEDULED
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APRIL 14.

2. SRI LANKA ECONOMY, WHICH HAD SHOWN SIGNS OF REVIVAL IN
1975, WAS SET BACK IN 1976 BY A SEVERE DROUGHT AFFECT-
ING BOTH PADDY AND TREE CROP PRODUCTION. AGRICULTURAL
OUTPUT DECLINED BY 3.6 PERCENT AND GNP GROWTH WAS REDUCED
TO 2.5 PERCENT, AS AGAINST THE 3.6 PERCENT GROWTH RATE OF

THE YEAR BEFORE. COUNTRY'S BALANCE OF PAYMENTS POSITION IMPROVED IN 1976, OWING PRIMARILY TO REDUCED IMPORTS. TRADE DEFICIT WAS CUT FROM \$202 MILLION IN 1975 TO \$58 MILLION IN 1976, AND RESERVES ROSE FROM \$58 MILLION TO \$92 MILLION. HOWEVER, WITH FOREIGN DEBT OF \$991.4 MILLION (END-1975) AND DEBT SERVICE RATION OF 20.3 PERCENT, SITUATION REMAINS EXTREMELY TIGHT. WITH FOODGRAINS, PETROLEUM, AND FERTILIZER ACCOUNTING FOR TWO-THIRDS OF A LIMITED IMPORT BUDGET, LITTLE IS LEFT FOR ESSENTIAL RAW MATERIALS AND SPARE PARTS, LET ALONE LESS ESSENTIAL FOODSTUFFS.

3. SUGAR IMPORTS AVERAGED SLIGHTLY LESS THAN 50,000 TONS ANNUALLY DURING 1974-76, WHICH COMPARES WITH AN AVERAGE 247,000 TONS DURING 1968-73. THE 45,930 TONS IMPORTED IN 1976 WERE AUGMENTED BY DOMESTIC PRODUCTION OF 39,907 TONS (BOTH CENTRIFUGAL SUGAR AND JAGGERY) TO ACCOUNT FOR COUNTRY'S CONSUMPTION OF 85,000 TONS (PRE-SUMABLY A SMALL AMOUNT WAS STOCKPILED). THE 1976 CONSUMPTION FIGURE, IN TURN, WAS LOWEST LEVEL ON RECENT RECORD AND COMPARES WITH PEAK CONSUMPTION OF 280,000 TONS IN 1971. PER CAPITA CONSUMPTION, AT 13.8 LBS. (1976), IS FAR BELOW MINIMUM STANDARD OF 23 LBS. PER ANNUM RECOMMENDED BY NUTRITIONISTS. ON BASIS THIS STANDARD, CURRENT REQUIREMENTS OF SRI LANKA ARE ABOUT 140,000 TONS AND WOULD RISE TO 150,000 TONS IN 1980, 165,000 TONS IN 1985.

4. DOMESTIC SUGAR PRODUCTION IN 1976 COMPRISED 22,907 LIMITED OFFICIAL USE

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TONS OF CENTRIFUGAL SUGAR AND 17,000 TONS OF JAGGERY, PRODUCED FROM SUGAR CANE AND VARIOUS SPECIES SUCH AS PALMYRAH, COCONUT, AND KITUL. CONSIDERING THAT COMBINED OUTPUT WAS ONLY 12,000 TONS AS RECENTLY AS 1973, GOVT HAS MADE FAIRLY GOOD PROGRESS IN PROMOTING GROWTH OF INDUSTRY. PROSPECTS FOR THE TWO TYPES VARY, BUT BASED ON PRESENT PLANS AND FORESEEABLE FUTURE DEVELOPMENTS (NOT INCLUDING POSSIBLE NEW BANK PROJECT), PRODUCTION HAS MAXIMUM POTENTIAL OF 97,000 TONS BY 1985, AS FOLLOWS:

(A) CENTRIFUGAL (68,000) - PRESENT PRODUCTION IS WELL BELOW POTENTIAL OWING TO VARIETY OF PROBLEMS - NOTABLY LACK OF DEVELOPED LAN AND IRRIGATION WATER, EQUIPMENT SHORTAGES AND POOR MANAGEMENT - HAMPERING OPERATIONS OF COUNTRY'S TWO CENTRIFUGAL PLANTS, KANTALAI AND GAL OYA. THESE SHORTCOMINGS ARE NOW BEING REMEDIED WITH AID OF FOREIGN LOANS (IDA FOR KANTALAI, BANK FOR GAL OYA (LOAN NO. 123-SRI)), WITH RESULT THAT BY 1980 PRODUCTION SHOULD REACH 19,000 AND 21,000 TONS AT

KANTALAI AND GAL OYA, RESPECTIVELY. FURTHER INCREASES,

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OF 19,000 TONS AT KANTALAI AND 9,000 TONS AT GAL OYA,
COULD BE REALIZED BY 1985 ON BASIS OF FEASIBILITY STUDIES
RECENTLY COMPLETED.

(B) JAGGERY (29,000) - JAGGERY IS PRODUCED MAINLY BY
SOME 300 PLANTS IN BADULLA AND MONERAGALA DISTRICTS OF UVA
PROVINCE. FEASIBILITYSTUDY RECENTLY COMPLETED BY FAO UNDER
FAO/IBRD AUSPICES, RECOMMENDS DOUBLING OF PRESENT PRO-
DUCTION IN THAT AREA, TO 24,000 TONS, THROUGH DEVELOPMENT
OF 5,500 ACRES OF CANE. NO DECISION YET TAKEN ON
FINANCING.

5. EVEN IF ALL PROPOSALS ARE FULLY IMPLEMENTED, COUNTRY
WOULD STILL HAVE DEFICIT (BELOW MINIMUM NUTRITIONAL
STANDARD) OF OVER 50,000 TONS IN 1980, 70,000 TONS IN
1985. GOVT INTENDS MEET PART OF SHORTFALL BY ESTAB-
LISHING SUGAR/JAGGERY INDUSTRY ON LEFT BANK OF WALAWE
IRRIGATION SCHEME IN SOUTHERN PART OF COUNTRY, TO BE
KNOWN AS SEVANAGALA SUGAR DEVELOPMENT PROJECT. FEA-
SIBILITY STUDY ON PROPOSED PROJECT HAS BEEN PREPARED
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BY FRENCH CONSULTANTS IN 1973, BUT REEXAMINATION WAS CONSIDERED NECESSARY IN VIEW TECHNOLOGICAL AND OTHER DEVELOPMENTS AFFECTING MAJOR PARAMETERS OF PROJECT.

6. BANK FACT-FINDING MISSION VISITED SRI LANKA AT GOVT INVITATION IN MARCH 1976 AND WAS SHOWN AFOREMENTIONED FEASIBILITY STUDY. ON BASIS THAT STUDY AND ITS OWN ASSESSMENT, MISSION RECOMMENDED DETAILED PREPARATION FOR A PROJECT HAVING FOLLOWING PARAMETERS: (A) CANE CULTIVATION UNDER IRRIGATED CONDITIONS; (B) SUGAR MANUFACTURE BASED ON A MODERN PAN VACUUM FACTORY, (C) PRODUCTION OF CANE ON ESTATE BASIS RATHER THAN UNDER SMALL-HOLDER ARRANGEMENT. SUBSEQUENTLY, REASSESSMENT OF MAJOR ASSUMPTIONS WAS UNDERTAKEN AND IT WAS CONCLUDED ALL THREE NEEDED DETAILED FURTHER EXAMINATION IN ORDER ASSURE AN OPTIMUM PROJECT.

7. QUESTION OF ADEQUACY OF IRRIGATION ARISES AS RESULT OF BANK EXPERIENCE IN AREA. PROJECT AREA FORMS PART OF LARGER WALAWE DEVELOPMENT SCHEME UNDER WHICH SOME 62,000 NET ACRES OF LAND ARE TO BE IRRIGATED FROM UDA WALAWE RESERVOIR. FIRST PHASE OF THIS DEVELOPMENT, CONCERNED WITH IRRIGABLE AREA ON RIGHT BANK OF WALAWE RIVER, WAS UNDERTAKEN UNDER WALAWE DEVELOPMENT PROJECT, BANK'S FIRST INTEGRATED RURAL DEVELOPMENT PROJECT APPROVED IN OCT 1969 (LOAN NO. 16 (SF) AND 17-SRI). PROPOSED TA WOULD INVOLVE PREPARATION OF A DEVELOPMENT PROJECT FOR NORTHERN PART OF WALAWE LEFT BANK WITHIN CONTEXT OF OVERALL SCHEME. WHILE PRIOR STUDIES HAD INDICATED AVAILABILITY OF ADEQUATE WATER FROM UDA WALAWE RESERVOIR, OPERATING EXPERIENCE HAS SHOWN MORE WATER USED THAN EXPECTED OWING TO OVER-APPLICATION, CANAL SEEPAGE, IMPROPER OPERATING PROCEDURES, ETC., AND THAT ULTIMATE DEMANDS ON LEFT BANK, POSSIBLY INCLUDING SEVANAGALA AREA, MIGHT NOT BE SATISFIED UNLESS MORE EFFICIENT USES OF RIGHT BANK ARE APPLIED AND/OR SUPPLEMENTAL SOURCES DEVELOPED. CONSULTANTS UNDER TA WOULD ACCORDINGLY BE LIMITED OFFICIAL USE

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REQUIRED TO REASSESS WATER BALANCE FOR WALAWE BASIN, INCLUDING POSSIBLE SUPPLEMENTARY SOURCES, AND TO MAKE PRIORITY ALLOCATION OF LEFT BANK WATER SUPPLIES BASED ON COMPARATIVE COSTS OF IRRIGATION BENEFITS AND COSTS TO BE DERIVED.

8. WITH REGARD TO PROCESSING METHOD, RECENT TECHNOLOGICAL DEVELOPMENTS TOGETHER WITH CHANGES IN EQUIPMENT COSTS SUGGEST NEED FOR PRESENT VALUE ANALYSIS AMONG ALTERNATIVE PROCESSING METHODS, I.E., JAGGERY, KHANDSARI,

SMALL SULPHITATION FACTORIES, AND CONVENTIONAL VACUUM PAN FACTORIES. FINALLY, CHOICE OF TECHNOLOGY, AS WELL AS SOCIAL CONSIDERATIONS WILL BEAR ON QUESTION OF SMALL-HOLDER VS. ESTATE ARRANGEMENT.

9. EVENTUAL PROJECT, TO WHICH BANK NOT COMMITTED AT THIS TIME, WOULD COST AN ESTIMATED \$40 MILLION, OF WHICH FOREX COSTS WOULD BE \$25 MILLION, COSTS COULD BE BROUGHT DOWN THROUGH USE OF DIFFERENT TECHNOLOGIES THAN ORIGINALLY CONTEMPLATED (PARA. 6). PROJECT WOULD INVOLVE: (A) DEVELOPMENT OF ABOUT 12,500 NET ACRES OF PRESENTLY UNDERDEVELOPED LAND AND POSSIBLE CONVERSION TO CANE OF ABOUT 3,000 NET ACRES PRESENTLY CULTIVATED WITH PADDY; (B) ESTABLISHMENT OF MANUFACTURING FACILITIES; (C) SETTLEMENT OF POPULATION REQUIRED

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FOR PROCESSING OPERATIONS, INCLUDING SUPPORTIVE INFRA-STRUCTURE.

10. SRI LANKA SUGAR CORPORATION (SLSC) WILL BE EXECUTING AGENCY FOR PROPOSED TA. SLSC WAS ESTABLISHED IN 1966 AS SUCCESSOR OF KANTALAI SUGAR CORP. FOLLOWING GOVT DECISION TO INTEGRATE MANAGEMENT OF ALL SUGAR PRODUCTION UNDER ONE STATE-OWNED CORPORATION. IT IS MANAGED BY BOARD OF SIX DIRECTORS, ALL OF WHOM ARE NOMINATED BY MINISTER OF AGRICULTURE AND LANDS. SINCE ITS FORMATION

SLSC HAS MANAGED BOTH KANTALAI AND GAL OYA FACTORIES AND HAS BEEN EXECUTING AGENCY FOR BANK'S GAL OYA PROJECT. IT HAS IMPROVED OPERATIONS AND UPGRADED ORGANIZATION AND MANAGEMENT AT BOTH PLANTS. IN IMPLEMENTATION OF TA, SLSC WILL OBTAIN ASSISTANCE FROM OTHER CONCERNED GOVT AGENCIES. BANK CONSIDERS SLSC QUALIFIED TO ACT AS EXECUTING AGENCY.

11. PROPOSED TA CALLS FOR DETAILED ASSESSMENT OF MAJOR QUESTIONS (LISTED PARA. 6, DISCUSSED PARAS. 7 AND 8)
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ARISING SINCE VISIT OF BANK MISSION IN MARCH 1976, AND PREPARATION OF COMPREHENSIVE AND PHASED DEVELOPMENT PROGRAM FOR CONSTRUCTION OF PROPOSED PROJECT FACILITIES. SERVICES OF INTERNATIONAL CONSULTING FIRM TO BE ENGAGED WITH EXPERTISE IN SUGAR CANE AGRONOMY; HYDROLOGY, IRRIGATION AND DRAINAGE; SUGAR PROCESSING; AGRICULTURAL MACHINERY; CIVIL ENGINEERING; ECONOMIC AND FINANCIAL ANALYSIS; AND INSTITUTIONAL ASPECTS. ADB BOARD APPROVED, ON NO OBJECTION BASIS, ISSUANCE OF INVITATIONS TO SHORT-LISTED CONSULTANTS IN ADVANCE OF BOARD APPROVAL OF TA IN ORDER THAT CONSULTANTS MIGHT COMMENCE THEIR ASSIGNMENT BY JULY 1 AND COMPLETE THEIR WORK DURING COMING DRY SEASON (SEE REFTEL). ABOUT 35 MAN-MONTHS OF CONSULTANT SERVICES WILL BE NEEDED FOR COMPLETION OF REQUIRED STUDIES.

12. FOREX COSTS OF PROPOSED TA, ESTIMATED AT \$350,000, WILL BE FINANCED BY EUROPEAN ECONOMIC COMMUNITY (EEC) UNDER FINANCING ARRANGEMENTS CONCLUDED BETWEEN BANK AND EEC ON 7 JAN 1977 (SEE ADB DOC. IN4-77). UNDER AGREEMENT, EEC IS FINANCING EIGHT TA PROJECTS TALLING \$1,875,000. GOVT OF SRI LANKA HAS AGREED TO EEC FINANCING OF FOREX COSTS AND HAS AGREED TO FINANCE LOCAL CURRENCY COSTS ESTIMATED AT \$40,000.

13. PROPOSED TA, WHICH IS IN LINE WITH DEVELOPMENT PRIORITIES OF SRI LANKA, WOULD PREPARE BASIS FOR A CONSIDERABLE INCREASE IN SUGAR PRODUCTION NEEDED TO IMPROVE PRESENT INADEQUATE PER CAPITA CONSUMPTION LEVEL. IT WOULD RESULT IN OPTIMUM USE OF PRESENTLY IDLE LAND, CREATE EMPLOYMENT OPPORTUNITIES AND GENERATE FARM INCOME. USADB SUPPORTS PROPOSAL AND RECOMMENDS FAVORABLE NAC ACTION.

14. REQUEST AMEMBASSY COLOMBO COMMENTS FOR NAC AGENCIES, INFO USADB MANILA, PURSUANT TO STATE 119795
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